Before the FEDERAL COMMUNICATIONS COMMISSION Washington, D.C. 20554

In the Matter of)	
)	
Annual Assessment of the Status of)	MB Docket No. 06-189
Competition in the Market for the)	
Delivery of Video Programming)	

comments of cable THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

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November 29, 2006

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COMMENTS OF THE NATIONAL CABLE & TELECOMMUNICATIONS ASSOCIATION

The National Cable & Telecommunications Association ("NCTA"), by its attorneys, submits the following comments on the status of competition in the market for the delivery of video programming. NCTA is the principal trade association of the cable television industry. Its members provide video programming, broadband Internet, wireline phone, and other services throughout the United States. NCTA also represents programmers and suppliers of equipment to the cable television industry.

INTRODUCTION & SUMMARY

Today's marketplace for the delivery of video programming to consumers could hardly have been foreseen when Congress first directed the Commission to provide annual reports on the status of competition. Even the viability of direct broadcast satellite (DBS) service, which was just being launched, was still an open question. The notion that two national DBS competitors would, in 14 years, have captured 30% of all multichannel video programming customers would have been viewed as wildly optimistic.

But today the vigorous head-to-head competition between cable operators and the two DBS companies is just the tip of the iceberg, and the idea of an annual report focused solely on the state of video competition seems anachronistic, a bit like asking the Federal Aviation Administration in 1912 to report on whether there is airline competition in 2006. Digital technology – along with the investment by cable operators of more than \$100 billion to use that technology – have completely transformed the marketplace in which video programming services are delivered to consumers. Cable operators deployed that technology in order to offer their customers a much greater number of channels of programming, along with the enhanced video and audio quality associated with digital transmission. But it has also enabled them to provide high-speed Internet service (unheard of in 1992), and to offer robust and fully competitive telephone service throughout the nation.

In *each* of the three services that cable operators now provide – video, Internet, and telephone – they face, and they provide, vigorous competition. And, as the result of this competition, customers of each of these services are able to choose from a variety of options that maximize value at competitive prices.

With respect to multichannel video services, the Commission's previous annual reports have documented the steady growth of DBS services into a full-fledged competitor of cable. Throughout the nation, virtually every consumer can now choose from among at least three fully competitive alternatives, including a cable operator and the two national DBS services. And this year, the report should document the steadily growing availability of cable service from a fourth provider – the local telephone company. At long last, after abandoning their video efforts of a decade ago, the Bell Companies are beginning to offer a competitive multichannel service.

The telcos initially sought to portray the cable franchising process as an insuperable barrier to their ability to deploy their services and compete effectively with existing cable operators. But this rhetoric has been overtaken by the facts. As Verizon now admits, cities are "eager to bring competition to market," "franchising is not an issue for us," and "franchising is not holding us back." Yesterday Verizon announced its 231st franchise.4

Video competition is producing a cornucopia of viewing options, in a manner that maximizes consumer value. Beyond the basic broadcast tier, which all cable customers are required by law to purchase, cable operators typically provide an additional analog tier of services, digital tiers and mini-tiers (including, in many cases, a "family viewing" tier), premium movie and sports channels, pay-per-view and video-on-demand services – all available as optional choices to customers. As the testimony and evidence in the Commission's à la carte inquiry demonstrated, the offering of many services in tiers instead of on a per-channel basis enables operators to offer customers a larger and more diverse array of program services. And it enables customers to view more of the channels that they value at a lower cost.

Moreover, while video competition is expanding the service offerings and options provided by cable operators and DBS services, these Multichannel Video Programming Distributors ("MVPDs") continue to face additional competition from other sources old and new. Broadcasters are in the midst of a digital transition which is giving them additional flexibility in deciding how to use their spectrum to maximize value to consumers. They are already using

¹ http://investor.verizon.com/news/20060927/20060927.pdf.

http://investor.verizon.com/news/20060927/20060927 transcript.pdf.

 $^{^3}$ 1d

⁴ "Verizon Gets Franchise," Communications Daily, November 29, 2006 at 2.

their digital spectrum to offer high definition programming and multiple channels of multicast programming over-the-air to viewers. In addition, home video and, increasingly, mobile video rentals compete with cable operators not only for the attention of television viewers but, specifically, in the sale of movies and other services typically offered by cable on a per-program basis.

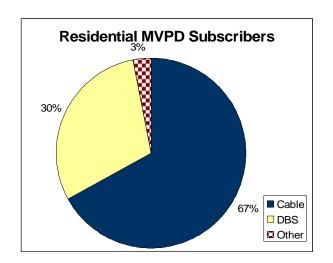
Finally, with Internet access speeds increasing exponentially, video competition from the Internet is offering yet another viewing option for consumers. Streaming video on the Internet is offering a multitude of options, ranging from short-form video clips on innumerable sites to full-length movies offered at a fee on a per-program basis. And Internet viewing is no longer tethered to the desktop computer. Streaming video can be viewed on television sets in the living room – or, at the opposite extreme, on tiny wireless telephones.

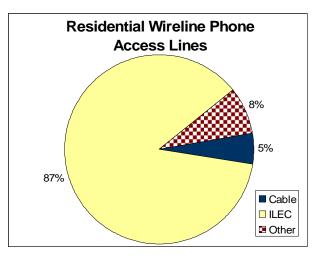
All of these Internet viewing options exist because of the provision of high-speed Internet access, which the cable industry was the first to provide to American consumers. While telephone companies are only now beginning to deploy competitive video services, they are already vigorous competitors in the provision of high-speed Internet service throughout the nation. They were late starters, holding back on the provision of DSL service (which competed with their higher-priced T1 and ISDN lines) until cable operators demonstrated that there was a consumer market for their high speed cable modem service. But today 38.3% of the nation's high-speed Internet households purchase DSL service. Meanwhile, new technologies, including Wi-Fi, Wi-MAX, and Broadband over Power Lines (BPL) are poised to provide additional competition to both cable modem service and DSL service.

Here, again, competition is enhancing choice and value for consumers. Technological developments are not only making it possible to offer customers higher and higher speed access

to the Internet. They are also enabling customers to choose the speed and bandwidth that they need, so that those who use the Internet to upload and download large amounts of data can do so at a higher price, while those who rely on the Internet solely for e-mail and browsing of information can satisfy their needs at a lower price. As new bandwidth-intensive uses of the Internet continue to develop, cable operators will need to continue to find innovative ways to ensure that those uses are available to those who value them, while also keeping high speed service available and affordable to as many households as possible.

But when it comes to the state of wireline phone competition...





Source: Kagan Research LLC, as of September 2006

Source: FCC Local Telephone Competition Report, as of December 2005

As of Year End 2005, more than 87% of all households still purchased telephone service from the incumbent local exchange carriers in their communities. Indeed, this has been the toughest communications marketplace in which to introduce real and sustained choice and competition. Cable's core video marketplace is more vigorously and fully competitive; the ILECs still dominate their core telephone marketplace.

Congress sought to encourage local exchange competition with the Telecommunications Act of 1996, and, in fact, there was a brief flowering of competitive local exchange carriers in the aftermath of the Act.

But, as Congress recognized, because of the unique circumstances of the local exchange marketplace, telco competition required cooperation from the incumbents. First of all, incumbents would have to make available certain "unbundled network elements" that would enable CLECs to compete without having to replicate the entire facilities of the ILECs. Second, telco competition requires that non-incumbent customers be able to call the incumbent's customers, and vice versa. And this, in turn, means that even facilities-based CLECs need to be able to interconnect with ILECs if they are to attract any customers at all.

The ILECs litigated and frustrated every effort by the Commission to implement the Act in a manner that facilitated CLEC competition. Many competitors were crushed. And after ten years, competition largely failed to take hold – with one important exception. The cable industry, unlike most of the failed CLECs, has deployed its own broadband facilities, which are capable of providing competitive telephone service to 93% of the nation's homes. Cable phone service is now available to more than 78% of those homes, and more than 8.5 million households have already chosen this alternative to their incumbent telephone company's service.

But now that telephone companies and cable operators are competing head-to-head with bundled video, Internet and telephone service offerings, it is more important than ever that the ILECs not be permitted to use their market power to stifle new telephone competition. Cable provides the best prospect for long-term wireline telephone competition. And because cable service is increasingly being welcomed by consumers delivered as part of a bundle that *includes* telephone service means, telephone companies can, by hindering cable's ability to provide

telephone service, gain an unfair advantage and distort if not ultimately destroy competition in the provision of video and Internet services as well. The danger is clear, and the need for Commission action to remove barriers to facilities-based phone competition is compelling.

In the past dozen reports, the Commission has observed the rapid, steady and irreversible growth of investment and competition in the video marketplace. And, with a wise policy of "vigilant restraint," it has nurtured innovation and competition in the provision of high-speed Internet services. By constraining, through targeted and efficient policies, the unique ability of the ILECs to thwart competition in their core telephone business, the Commission can ensure that these competitive developments continue – and that competition finally and firmly takes hold in the telephone marketplace, as well.

I. COMPETITION IS THE HALLMARK OF TODAY'S VIDEO MARKETPLACE, WHICH IS MARKED BY AN UNPRECEDENTED ARRAY OF VIDEO PROGRAMMING DISTRIBUTORS OFFERING A DIVERSE MIX OF VIDEO PRODUCTS AND SERVICES

Almost three years ago, the Commission concluded in its 10th Annual Report on the status of competition in the video marketplace that "the vast majority of Americans enjoy more choice, more programming and more services than any time in history." A year later, it further confirmed that "almost all consumers have the choice between over-the-air broadcast television, a cable service, and at least two direct broadcast satellite (DBS) providers" and found that "in some areas, consumers may also choose" to receive service via one or more emerging technologies, including digital broadcast spectrum, fiber, and video over the Internet. Earlier this year, in its 12th Annual Report, the Commission echoed its previous findings, highlighting that "[c]ompetition in the delivery of video programming has provided consumers with increased choice, better picture quality, and greater technological innovation."

In 2006, three years after the Commission first recognized that video competition had irreversibly taken hold, competition among providers is even more deeply rooted in the communications landscape. Cable, satellite, broadband and increasingly telephone providers are competing head-to-head for every customer. And as this past year shows, jockeying for customers between multichannel video distributors competing against one another and against a barrage of newer video players keeps ratcheting up as the forces of technological change make

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See e.g., Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 19 FCC Rcd 1606, 1608 (2003)("10th Annual Report").

⁶ See e.g., Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 20 FCC Rcd 2755, 2757 (2005)("11th Annual Report").

⁷ See e.g., Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, 21 FCC Rcd 2503, 2506 (2006)("12th Annual Report").

new and different video delivery mechanisms possible. The growth in broadband combined with the versatility of the Internet has opened up all manner of new fronts in the ongoing video competition battle.

Looking solely at traditional multichannel video programming distribution, there is no starker proof of a competitive video marketplace than the fact that *nearly 32 million* consumers now subscribe to cable's competitors – DBS, alternative broadband providers, and local telephone companies that are just beginning to enter the marketplace. That's almost one of every three video subscribers. Fifteen years ago, cable operators had 95 percent of the multichannel video marketplace but today because of fierce competition from DBS and other broadband service providers, cable's share has dropped to less than 67 percent.

MVPD SUBSCRIBERS As of September 2006

	<u>Customers</u>	
MVPD	(in Millions)	Percent of Total
Cable	64.5	66.9%
DBS	28.9	30.0%
C-Band	0.1	0.1%
SMATV	1.0	1.0%
Wireless Cable	0.1	0.1%
Overbuilds	1.1	0.7%
<u>Others</u>	<u>0.7</u>	<u>1.2%</u>
Non-Cable MVPDs	31.9	33.1%
Total MVPD	96.4	100.0%

As multichannel video competitors duke it out for customers, Internet video has flooded the marketplace with competitive offerings that are attracting more and more consumer attention. Meanwhile, the broadcast and home video industries are not being left behind as they, too have introduced ways to leverage their strengths in the competitive video fray.

So, in light of this dynamic and ever-changing video marketplace, isn't it well past time for the Commission to recommend to Congress that an annual inquiry into the status of competition in the delivery of video programming is no longer necessary? The Commission has all but proclaimed it in the last three reports and the evidence this year is again abundantly and dramatically clear – as demonstrated in the brief overview of competitors below.

Direct Broadcast Satellite and Broadband Service Providers. The two nationwide DBS providers, DirecTV and EchoStar, are well-established proven competitors, having captured over 28 million customers. DirecTV ranks second and EchoStar ranks fourth among MVPDs with 15.678 million and 12.755 million customers respectively. Acquired by News Corporation in 2003, DirecTV is a giant vertically-integrated video provider offering 825 channels, including the Fox broadcast network, 10 of its own national cable networks, and 12 regional Fox cable networks. Through aggressive marketing and joint ventures with the telephone companies, little or no upfront consumer equipment costs, and channel line-ups including local broadcast signals, DBS has consistently added two to four million customers over the past five years.

Although DBS did not experience the double digit growth this past year that marked its remarkable ten-year climb, subscribership still increased by 6.7% between the third quarter of 2005 and the third quarter of 2006 (from 26.6 million to 28.4 million). By comparison, cable grew 0.3 percent in new basic customers during the same period, although it continues to significantly increase the number of customers migrating to its digital platform. DBS's state-by-

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See http://phx.corporate-ir.net/phoenix.zhtml?c=68854&p=irol-newsArticle&ID=927674&highlight and http://media.corporate-ir.net/media_files/irol/12/127160/pdf/Q306EarningsRelease.pdf.

⁹ Kagan Media Money, January 31, 2006 at 5, January 29, 2003 at 7.

state penetration continues to increase and total dish subscribership (C-Band and DBS) now exceeds 15 percent in 46 states. It exceeds 30 percent in 9 states and 20 percent in 36 states.¹⁰

As DBS grew by leaps and bounds, cable responded to this intense competition by expanding channel capacity and deploying premium tiers, video on-demand, high definition programming, and digital video recorder services. DBS in turn deployed its own advanced products and services, such as Dish Network's on-demand library with stop and start features and DirecTV's advanced DVR service. EchoStar also teamed with AT&T to provide IP-based video-on-demand service through AT&T's Homezone product. Cable is now wooing customers back and drawing in new subscribers by bundling advanced video, voice and data services.

This bundled "triple play" offers customers the convenience of one-stop shopping – a single provider to deal with and a single bill to pay. But the efficiencies of bundling also result in lower prices for consumers. The lower prices that cable customers pay when they purchase Internet and/or telephone service along with their cable service (as well as various promotional price offers) have not generally been taken into account when the Commission and others have analyzed and reported on cable prices.

Even in a vigorously competitive marketplace, there are factors other than competition that affect prices. Prices are, of course, a function of costs; if the costs incurred by cable operators and DBS operators go up, their retail prices will go up as well. And, in fact, costs *are* continuing to increase faster than inflation.¹¹ In particular, programming costs have increased markedly in the last year for cable operators – and presumably for *all* MVPDs. Competitive

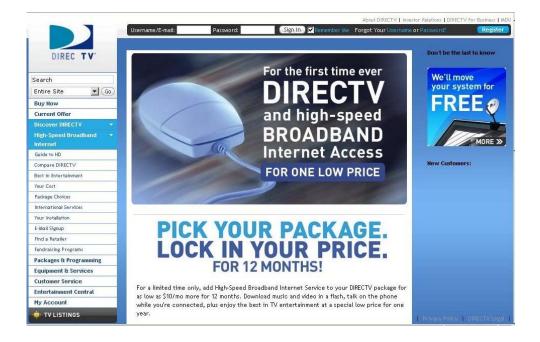
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Data as of November 2005, www.mbc-thebridge.com, Nielson Media Research.

See Chart, "Cable Operators' Programming Expenditures," at 35, infra.

providers have no choice but to carry services that are attractive to consumers lest they lose customers to their competitors. And they have no choice but to pass through the additional costs.

DirecTV and EchoStar's counter-move to the "triple play" bundle is to market broadband Internet access offered by WildBlue Communications in rural communities and join forces with the telephone companies to bundle their video services with telephone broadband service. DirecTV CEO Chase Carey views his company's alliances with Verizon, BellSouth, and Qwest (and EarthLink in AT&T territory) as "an increasingly strong competitive response" to cable's triple play. DirecTV has begun directly selling broadband with its video service, rather than relying solely on telco sales and marketing.



[&]quot;WildBlue Signs Wholesale Distribution Agreements with DirecTV and EchoStar," PR Newswire US, June 9, 2006; "EchoStar Signs Agreement to Distribute WildBlue High-Speed Internet Service," EchoStar Press Release, June 9, 2006. The companies also jointly bid on advanced wireless spectrum in August 2006 but later withdrew.

¹³ Satellite Week, August 14, 2006.

Similarly, Dish Network is marketing its own high-speed satellite-based service along with marketing telco DSL service on its website.



In densely populated, metropolitan areas of the country, cable and DBS also contend with major broadband service providers, such as RCN Communications, which are offering bundles of video, voice and data services. RCN serves 19 communities in top markets in the Northeast and Midwest, including Massachusetts, New York, Pennsylvania, Washington, D.C., Chicago and Los Angeles. As cable operators ramp up their video-on-demand services, RCN has made improving its VOD product "a very strong initiative this year." RCN also recently began marketing wireless phone services to customers in the Boston area, along with its television, Internet and wireline phone service, in its bid to compete in the "quadruple play" arena. RCN hopes its wireless product will evolve from purely a phone service to a broadband wireless service offering video content and the ability to control customer equipment remotely. Four

[&]quot;MSOs Revamp VOD Strategies; Operators Roll Out More Local Fare, Interactive Services to Bolster Business," Multichannel News, May 1, 2006.

^{15 &}quot;RCN to market wireless service," Boston Globe, August 29, 2006; http://www.rcn.com/.

major cable companies, Comcast, Time Warner Cable, Cox Communications, and Advance/Newhouse Communications, have committed to a wireless phone venture that too is expected to evolve into a broadband wireless product.¹⁶

Wide Open West, Knology, Grande Communications and Wave Broadband are also competing against cable and DBS in various cities throughout the west. Their broadband operations are providing the latest technology, including high speed Internet, digital programming, digital video recorders, HDTV and free on demand services, to compete with MVPDs in their regions.

In addition, municipally-owned utilities compete with cable and other MVPDs in providing cable television and broadband services. According to the American Public Power Association, the number has slightly increased since last year, from 102 to 105 utilities providing cable service, and from 81 to 82 providing cable modem or DSL service.¹⁷

Bell Operating Companies. Looming over all of this competitive activity are the telephone companies, who are moving into the video marketplace on a massive, unprecedented scale. With 130 million access lines and \$150 billion in annual revenues, the Bell Operating Companies' (BOCs) immense size is a force to be reckoned with by all video providers even at this early stage in their deployment of video services. The Bell companies control roughly 90% of the revenue in residential and small business telephone markets, which gives them a massive perch in the communications marketplace to launch their video services and the kind of market power that can tip the balance unfavorably against cable and other competitors in the still

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See e.g., "Sprint Nextel, Comcast, Time Warner Cable, Cox Communications and Advance/Newhouse Communications to Form Landmark Cable and Wireless Joint Venture," Time Warner Press Release, November 2, 2005.

¹⁷ "Communities Provide More Services Every Year," American Public Power Association, <u>www.appanet.org</u>.

nascent competitive voice, data *and* video bundled services.¹⁸ While the Bells are, strictly speaking a "new entrant" in the video marketplace, they are certainly not start-ups.

Nevertheless, the BOCs began arguing last year, in Congress and at the Commission, that they needed to be free of many of the statutory and regulatory requirements that apply to cable operators. In particular, they maintained that they could not expeditiously deploy competitive video service if they were required to obtain cable franchises and comply with the obligations imposed by franchising authorities pursuant to Title VI of the Communications Act. In response to those requests for a regulatory boost vis-à-vis their cable competitors, the Commission initiated a proceeding to determine the extent to which any such relief was warranted and within its statutory authority.

In comments and ex parte filings in that proceeding – as well as comments in last year's video competition inquiry – NCTA showed that giving the phone companies such a regulatory advantage was neither warranted *nor* authorized by Title VI. We incorporate those filings by reference here.¹⁹ Jurisdictional issues aside, we pointed out that there was no reason to believe that franchise requirements were a barrier to the telcos' ability to deploy expeditiously their competitive service. We showed that Ameritech had no trouble a decade ago obtaining franchises at a rapid pace – until SBC acquired the company and terminated its video plans. And

As reported in the press, industry observers estimate that as many as 175 telcos and cable overbuilders have launched IPTV services over fiber-rich networks in smaller suburban and rural markets across North America. The installations range in size from several hundred to several thousand video subscribers by such emerging providers as SureWest Communications, Consolidated Communications, Pioneer Telephone Cooperative, CT Communications, South Slope Cooperative Communications Co., Bixby Telephone Co., Oxford Communications and Dakota Central Telecommunications, among others. "Smaller U.S. Telcos Roll Out IPTV While AT&T Struggles," Cable Digital News, June 1, 2006.

See In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992, MB Docket No. 05-311, NCTA Comments, filed February 13, 2006, and NCTA Reply Comments, filed March 28, 2006.

we showed that Verizon was, in fact, already obtaining franchises to deploy its video service at a rapid rate that exceeded its planned rate of deployment.

Now, even Verizon has conceded that the franchising process is not an obstacle to its ability to compete. As it readily admits, cities are "eager to bring competition to market," "franchising is not an issue for us," and "franchising is not holding us back." 22

In these circumstances, it would be wrong and at odds with the public interest for the Commission to relieve telephone companies of regulatory obligations that constrain and impose costs on incumbent cable operators. As Chairman Martin recently stated, "it is the Commission's responsibility to help ensure technological and competitive neutrality in communications markets. Accordingly, I believe that all providers of the same service must be treated in the same manner regardless of the technology that they employ."²³

Verizon has, in fact, successfully launched its television service, FiOS, in Keller, Texas and the service is now available to 1.2 million households²⁴ in parts of California, Florida, Maryland, Massachusetts, New York, Texas, and Virginia.²⁵ Verizon is laying fiber in large parts of 16 states across the country and expects to spend about \$23 billion by 2010 to reach 18 million homes by the end of the decade.²⁶

In the Matter of United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service, Memorandum Opinion and Order, WC Docket No. 06-10, FCC 06-165 (Statement of Chairman Martin).

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http://investor.verizon.com/news/20060927/20060927.pdf.

http://investor.verizon.com/news/20060927/20060927 transcript.pdf.

²² Id.

http://investor.verizon.com/news/view.aspx?NewsID=784.

http://newscenter.verizon.com/press-releases/verizon/2006/seven-more-communities-in-1.html.

Verizon FiOS Briefing Session; 9/27/06; pg.40, pg.10; http://investor.verizon.com/news/20060927/20060927.pdf.

AT&T's U-verse television service has launched in San Antonio, Texas and soon will be available in Houston and another 13 metropolitan markets in its 13-state region by the end of 2006. It expects to pass 2.4 million households by December and plans to ramp up marketing of the service in 2007.²⁷ AT&T's initial build out plans call for expenditures of approximately \$4.4 billion to reach 18 million households by 2008.²⁸ If the FCC approves its acquisition of BellSouth, AT&T, already the nation's largest telecommunications company, would gain another 20 million access lines in the U.S.

The fact that AT&T and Verizon have not launched more broadly in Texas, for example, has nothing to do with the ability to obtain franchises. After successfully obtaining legislation to vitiate the franchising process state-wide well over a year ago, the Bell companies could have initiated video service in many more communities than the 27 that they currently serve. This only shows that any delays in their deployment are not due to difficulties with getting a cable franchise.

Nevertheless, analysts expect a battle royale between cable and telephone companies in the years ahead, a factor which is already evidenced in the major advertising campaigns that the rival industries conducted this year targeting American consumers.³⁰ In an effort to lure customers away from cable, the telcos are spending millions upon millions to market themselves

AT&T 3rdQ '06 Earnings Conference Call, pg.16; http://library.corporate-ir.net/library/11/113/113088/items/217052/T3Q06EarningsConfCall Color.pdf.

AT&T 01/31/06 Analyst Conference; http://library.corporate-ir.net/library/11/113/113088/items/217052/T3Q06EarningsConfCall_Color.pdf.

By year-end 2006, Verizon hopes to offer video service to nearly 400,000 homes in Texas, or fewer than 5 percent of the 8.3 million total homes in the state. AT&T, which has a greater wireline footprint in the state than Verizon, is marketing its video service to fewer than ½ percent of homes in Texas.

UBS Investment Research, "Telecommunications Services," February 14, 2006; Stifel Nicolaus, "Telecom Services: Verizon Communications Inc.," August 7, 2006; Morgan Stanley Equity Research, "Cable/Satellite: Looking into 3Q2006 and 2007," October 25, 2006; Bank of America Equity Research, "Cable & Satellite TV: Battle for the Bundle: 3Q06 Wrap Up," November 15, 2006.

as the "next big thing" in the delivery of video, data and voice services. In an effort to differentiate itself from cable, for example, Verizon has launched a multi-room digital video recorder that enables customers to watch recorded shows on any television set in the house. AT&T launched Homezone TV and Internet service, which combines high speed Internet and satellite television in one set top box. Homezone offers digital video recording, movies on demand, photo and music sharing and web-based remote access. AT&T introduced the service in San Antonio, Texas and Ohio and plans to roll it out in other cities in the next several months.

Broadcast Television. Although the majority of U.S. households subscribe to a multichannel video programming service, 15 to 20 million American homes continue to rely solely on over-the-air broadcast television for their entertainment and information needs, representing at least 14 percent of all U.S. television households.³¹ Broadcasting is a robust medium that still garners substantial viewership on the national networks and local stations and healthy growth in ad revenues.³² With more than 1,584 stations nationwide on the air with digital signals, including virtually all network stations in the top 30 markets, broadcasters are well on their way to making the transition to digital.³³

Broadcasters are also entering the on-line video realm to promote their shows and profit from the Internet. This fall, NBC Universal, for example, began offering ad-supported episodes of some of its new prime time shows for free on-line viewing on personal computers. NBC

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³¹ 12th Annual Report at ¶ 96-97.

According to Television Advertising Bureau (TVB), in the most recent week, broadcast television delivered 98 of the top 100 rated programs. *See* Viewer Track Weekly Broadcast vs. Subscription TV Primetime Ratings: Week ending November 19, 2006 at www.tvb.org. Total advertising spending on broadcast television is expected to rise 8.7 percent to \$46.64 billion in 2006, according to an analysis by Veronis Schuler Stevenson, September 12, 2006, www.vss.com.

³³ See http://www.nab.org/AM/ASPCode/DTVStations/DTVStations.asp.

Broadband provides video clips for free to web sites in exchange for a piece of the advertising revenues. The Disney Company also offered episodes of seven of its hit ABC network shows on an ad-supported broadband outlet, and the Fox Network is offering its programming on-line as well. CBS too has leveraged the Internet platform to offer its primetime shows on-line, including free downloads in a video-on-demand joint venture with Comcast. And local stations are streaming popular local programming content and looking at new business models for distributing original programming and even multiple channels through the Web.

All the major broadcast networks are also releasing their programming through Apple's iTunes, which in just over a year has become the leading destination site for purchasing video downloads. In February, for example, NBC debuted its new drama series, "Conviction," on iTunes weeks prior to its network premiere in hopes of generating buzz for the program.³⁴ As of October 2006, 45 million television shows have been sold on iTunes, ³⁵ selling at a rate of over one million videos per week at \$1.99 per episode. iTunes touts a library of over 220 television shows from more than 40 broadcast and non-broadcast networks.³⁶ Some series are available on a monthly subscription basis for \$9.99. New episodes are available the day after telecast.

As video over the Internet grows, local broadcast stations in several markets have joined together to create a multichannel over-the-air service to compete with cable and satellite multichannel offerings. U.S. Digital Television, LLC launched USDTV in four cities, Albuquerque, Dallas, Salt Lake City, and Las Vegas, with up to 18 channels of local broadcast stations (and their high definition or multicast signals) and popular cable programming networks.

³⁴ "Brave new TV land," Time, March 13, 2006.

^{35 &}quot;The Gadget that Transformed TV," Television Week, October 9, 2006.

³⁶ "PBS programs now available on the iTunes Store," PR Newswire US, October 10, 2006.

This service is available for \$19.95 per month. Recently, NexGen Telecom purchased U.S. Digital Television's assets, and announced plans to expand the service.³⁷

Home Video Rentals and Sales. Just as some consumers rely on over-the-air broadcast television as the primary source for video delivery, others meet their video programming needs with the purchase or rental of digital video discs (DVDs). Although movie downloads appear to be the wave of the future in home entertainment, DVDs are currently the primary means of viewing movies and TV shows at home. With a market penetration of about 85% of U.S. households, DVD sales and rentals of DVDs continue to thrive. According to the Digital Entertainment Group, a DVD trade association, sales brought in \$16.3 billion last year and an additional \$6.5 billion in rental fees.

Netflix, the largest provider of movie rentals via mail, recently reported an unexpectedly strong third quarter, with its revenue for the period totaling \$246 million, a 48% increase over the same period last year. Netflix subscriber totals rose 58% to more than 5.6 million, and the company expects to have 6.3 million by the end of this year. Netflix anticipates continued strong growth through 2007.

³⁷ See http://www.usdtv.com/about/release-11-9-2006.html.

³⁸ "DVD duel: High-definition showdown," Orlando Sentential, June 24, 2006.

According to one analyst, DVDs will remain the primary distribution medium for movies for the next 5-plus years. "DVD or download?" www.cnnmoney.com (quoting recent report by Cowen & Co.). In an effort to capture the growing demand for high-definition technology, two different formats of high-definition DVDs have been introduced to the market: Toshiba's HD DVD and Samsung's Blue-ray Disc.

The number of DVD titles, both television shows and movies, has continued to increase. In 2005, 925 TV series were released on DVD; in the first nine months of 2006, 645 TV titles were released. A total of 12,264 DVD titles (including movies) were released in 2005, 532 more than in 2004. *See e.g.*, "No shortage of new DVDs," The Hollywood Reporter, January 12, 2006; DVD News, October 12, 2006.

^{41 &}quot;Good News for Netflix," Business Week Online, October 24, 2006.

Web-based rent-by-mail services have grown at the expense of traditional video-rental shops. Netflix CEO Reed Hastings predicted that between 500 to 1,000 video stores nationwide will close next year as a result of the influx of customers turning to the Internet for DVD rentals.⁴² In a recent report, PricewaterhouseCoopers projected that though the overall home video industry will continue to modestly grow in the coming years, the rapidly emerging market of online video sales and rentals will experience a significant boom.⁴³

Blockbuster, the country's largest video retail chain, introduced its own online video rental service in August of 2004. In one of its most significant competitive moves since the creation of its online services, Blockbuster announced in early November the immediate launch of a plan to allow its online customers to return movies both through the mail and at one of its 5,000 participating stores. The new plan, called "Blockbuster Total Access," is aimed at accomplishing a faster shipping cycle, since videos returned in-store will automatically be registered as returned, signaling the next movie on the subscriber's queue to be delivered. Furthermore, Blockbuster is giving customers a free in-store rental if they return a movie ordered online in stores. Total Access is being heralded as a much needed trump card to compete with Netflix's pure online business model.⁴⁴

In addition, both Blockbuster and Netflix are taking steps to develop services that will deliver movies through high-speed Internet connections. Wal-Mart, which currently accounts

⁴² "Netflix 3Q profit tops analyst estimates as customer base grows," Associated Press Financial Wire, October 23, 2006.

The firm estimates that by 2010 the market for online video sales and rentals will hit \$3.6 million, whereas instore rentals will fall to around \$6.2 billion. *Id.* at 3.

[&]quot;New rental idea seen as big building block," Dallas Morning News, November 2, 2006; "Stressed over Netflix," Daily Variety, November 2, 2006.

for about 40% of all DVDs sold in the U.S., is also reportedly preparing an online movie downloading service of its own.⁴⁵

Internet Video and Mobile Video. As wireline and satellite distributors compete for customers tooth and nail, and the home video industry expands its universe of potential video buyers, all video programming distributors face growing competition for eyeballs and ad dollars from on-line video offerings. Indeed, video has permeated the Internet over the past year as broadband access further penetrates American households and consumers increasingly look to the Web, through their PCs, TVs, and handheld mobile devices, as another medium for the delivery of video content. New outlets for original and repurposed video content emerge everyday and media companies are racing to enter this burgeoning marketplace with web-based services.

The Internet is proving to be a viable, competitive video alternative capable of shaking up the entire marketplace. The recent rise of YouTube illustrates the growing appetite for personalized, non-traditional video entertainment, especially among younger consumers. Internet search titan, Google, Inc., purchased YouTube for \$1.65 billion after only 20 months in business. And YouTube just inked a deal with Verizon Wireless to provide a "television-like" channel featuring its most popular videos to V-Cast cell phone customers.⁴⁶

As do-it-yourself Internet video continues to find an audience, the downloading of high quality, high demand Hollywood movies and TV shows has been steadily growing in popularity over the past several years. Backed by major computer industry players, Microsoft Corporation and Cisco Systems, Inc., CinemaNow offers digitally compressed movies on a pay-per-rental or

 $^{^{\}rm 45}$ "Target Seeks Equity on DVDs," Los Angeles Times, October 10, 2006.

⁴⁶ "Hello, CellPhone? YouTube Calling," The Washington Post, November 28, 2006.

download-to-own basis. Movielink LLC, another film and TV download service, is owned by five major movie studio owners (Metro-Goldwyn-Mayer Inc., Viacom Inc., Sony Corporation, GE's NBC Universal, and Time Warner Inc.). The service currently offers over 2,000 films, with rentals starting at 99 cents up to \$4 and purchase prices are comparable to DVDs. 47 Movielink announced in July 2006 that customers will be able to copy their downloaded movies onto DVDs and play them on DVD players starting in the first quarter of 2007 – a service already offered by CinemaNow. Meanwhile, CinemaNow is working with EchoStar to develop a Dish Network receiver that will be able to access its movies. 48 And last April Movielink and CinemaNow began making movies available for download on the same day that the DVD hits the shelves.

The recent entry of multiple household-name companies, Apple Computer, Amazon and AOL, into the video marketplace promises to boost Internet-based home delivery of movies and other entertainment as a competitive alternative to other video services. Apple launched its online movie service in September 2006 and its arrival is particularly noteworthy given the company's track record in revolutionizing the music industry with online downloads to its now ubiquitous portable entertainment device, the iPOD. With only 75 Disney movies in its library, Apple generated \$1 million in less than a week through the sale of 125,000 movie downloads.⁴⁹ Under its deal with Disney, Apple will be able to put new movies up for sale at the same time

⁴⁷ "Films at your fingertips," Pittsburgh Post-Gazette, July 11, 2006.

⁴⁸ "The lowdown on movie downloads," Los Angeles Times, October 1, 2006.

⁴⁹ *Id*.

they arrive on DVD.⁵⁰ Downloaded films can be played on a Mac or PC-based computer, and can also be transferred to a video iPod for repeated playback.⁵¹

Starz Entertainment Group, in partnership with Microsoft and Sony, launched its own online movie service, Vongo, in June of this year. Vongo hopes to become a "one-stop shop for broadband movie and entertainment enjoyment," according to Bob Greene, senior VP of advanced services for Starz. For \$9.99 a month, subscribers gain unlimited access to Vongo's more than 1,600 movies and video (available for playback on Windows-based PCs, select portable devices, and television sets), in addition to a live, online streaming version of the Starz TV channel. Individual movies can be downloaded on a pay-per-view basis for \$3.99 each, and users can download content to a maximum of three devices per account. Through its alliance with Microsoft, Vongo is compatible with multiple portable video players. Vongo has also joined hands with big-name player AT&T, which will offer Vongo to its high-speed Internet customers and market the service on the AT&T Worldnet portal and a co-branded website.

This fall, the "Fox Reality" program network and Apple partnered in an arrangement that allows viewers to watch the premier episodes of all of its upcoming original series on iTunes at no charge one week before they air on television. ⁵⁶

⁵⁴ "Microsoft, Sony see Starz," Online Reporter, January 7, 2006.

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⁵⁰ "First music, then TV, now Apple to sell movies," Boston Globe, September 13, 2006. Films are priced at \$12.99 during their first week of release, and are subsequently raised to \$14.99; older movies will cost \$9.99.

Apple plans to unveil a new product next year (which it is currently calling iTV) that will wirelessly broadcast online-purchased movies from a user's computer to a standard television set. *Id.*

^{52 &}quot;Starz' Vongo net-based movie service goes live," Online Reporter, June 10, 2006.

 $^{^{53}}$ Id

⁵⁵ "Starz' Vongo net-based movie service goes live." Online Reporter, June 10, 2006.

⁵⁶ "Fox Reality bows on iTunes," Daily Variety, November 27, 2006.

Meanwhile, broadcast and nonbroadcast programmers are providing more and more streaming and downloadable video content on their Internet web pages. And exploiters of Internet technology continue to push the envelope in video distribution with the launch of services, such as LX.TV Lifestyle Television, a broadband channel featuring professionally produced, independent content.⁵⁷ Brightcove, an Internet TV company backed by veteran TV executive and entrepreneur, Barry Diller's IAC/Inter-Active Corp and AOL, plans to launch an online video marketplace that will facilitate deals between owners of movies, television programs and other videos and website owners.⁵⁸

The pursuit of the on-the-go consumer has become more aggressive in the past year as a wide range of companies explore ways to distribute pre-recorded, live and original video programming over mobile devices. In September, Sprint launched "Sprint Movies", which offers full length pay per view movies on mobile phones, including recent box office hits. A movie can be seen in its entirety all at once, or it can be broken up into chapters and watched over time; customers can also pause and skip forward or backward, similar to a DVD player.

Mobile-movie watching has grown in popularity, with subscriber growth averaging more than 30 percent a month since Sprint's mSpot movie subscription service was introduced in December 2005. Consumers can also get video clips on Verizon Wireless' V Cast phones and, as noted earlier, the company recently announced a joint venture with YouTube. Cingular is launching a new service that will allow consumers to use their cell phones to access video channels and

 $^{^{57}\,\,}$ "Site Bets Slick, Made-for-Web Shows are the Next Big Thing," Wall Street Journal, October 31, 2006.

⁵⁸ "Brightcove to Launch Online Video Marketplace," Wall Street Journal, October 31, 2006.

[&]quot;Sprint is First to Offer Full-Length "Pay Per View" Movies on Mobile Phones in U.S.," Business Wire, September 5, 2006.

download music, video content and browse the Internet at speeds comparable to cable modems or DSL lines.⁶⁰

Other recent examples of mobile video include a new generation of portable media players being promoted by EchoStar's Dish Network that enable customers to record and transfer movies and television programs to its portable "PocketDish" player. Discovery Communications also announced that it will launch Discovery Mobile at the end of 2006, a service that will include short video clips on travel and health, animal footage, fun facts, and clips from popular shows. Discovery Mobile at the end of 2006, a service that will include short video clips on travel and health, animal footage, fun facts, and clips from popular shows.

Analysts predict the number of people using mobile video could increase from roughly 7 million now to up to 12 to 24 million customers by 2010.⁶³

The foregoing demonstrates that the still-evolving Internet video distribution platform in all of its many variations is establishing a place in the competitive video arena. And in an era of younger, more technology savvy consumers open to video entertainment and information over multiple outlets, no industry player has a lock on this nor any other form of program delivery. Everyone is experimenting with new ideas, through capital investments in existing entities, startups and joint ventures, all with the knowledge that the only sure thing is that nothing is settled. This goes for companies within the same industry *and* those competing against companies in other industry sectors. And this is as it should be in a fully competitive video marketplace.

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[&]quot; Id

⁶¹ "Portable Media Players Aim for the Masses," The New York Times, October 19, 2006.

⁶² "Shooting for a Bigger Audience on the Smaller Screen; Discovery Aims for Escape the Confines of the Television with Video Tailored for Cellphones," The Washington Post, July 17, 2006.

⁶³ "Video to go," St. Louis Post-Dispatch, September 8, 2006 (quoting Jupiter Research and IDC of Framingham, Mass., respectively).

II. TO MEET THE COMPETITION, THE CABLE INDUSTRY CONTINUES TO PACKAGE AND PROVIDE PROGRAMMING AND NEW CUTTING EDGE SERVICES THAT MAXIMIZE CONSUMER CHOICE AND VALUE

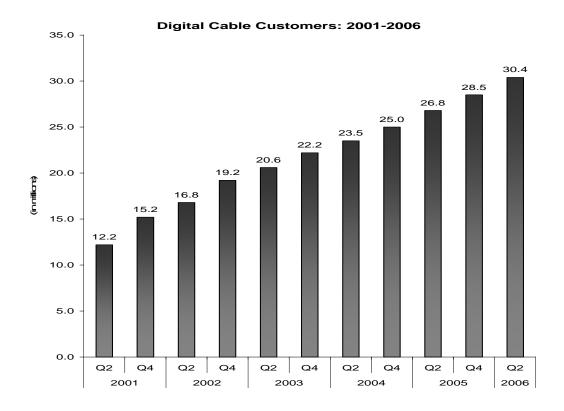
In a ferociously competitive video marketplace, "where rapid technological change confounds business assumptions every day," 64 cable companies are driven to innovate and create newer and better service offerings for their customers. By investing over \$100 billion to construct an advanced two-way fiber optic network, cable operators increased their channel capacity *nearly two-fold* to deliver more than 200 video channels in nearly every community nationwide. It is estimated that the industry will expend over \$11 billion during the twelve months of 2006 in capital improvements. 65 The wisdom of this continuing infrastructure upgrade has been borne out by consumer zeal for digital cable programming options, including increased subscriptions for packages of sports, foreign language, international, family-oriented and niche programming.

At the end of June 2006, over 45 percent of cable subscribers, or 32.9 million, had chosen a digital cable package from their cable company. This marked a 22 percent increase from June 2005.

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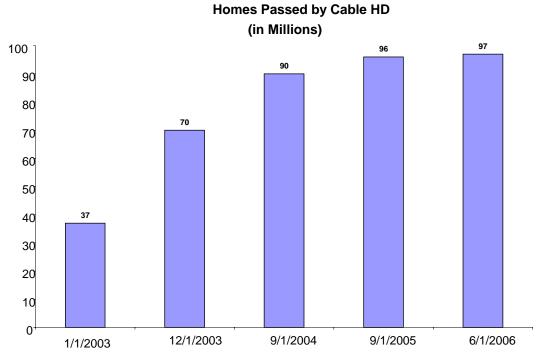
Remarks by Brian L. Roberts, Chairman and Chief Executive Officer, Comcast Corporation before the Progress and Freedom Foundation, Washington, D.C., September 21, 2006.

⁶⁵ Kagan Research, LLC, Broadband Technology, April 18, 2006 at 2.



Source: NCTA estimate based on company data.

Consistent with its long-standing efforts to advance the transition to digital television, cable operators also continue to aggressively market HDTV services. High definition channels are now widely available to cable customers, with systems offering upwards of 25 HD channels and additional HD programming on demand. By June 2006, 97 million U.S. television households were passed by at least one cable system offering HDTV service, which represents all of the top 100 designated market areas (DMAs). Of all DMAs, a total of 203 markets (out of 210) were served by at least one cable system that offers high-definition programming.



Source: NCTA research based on company data.

Cable networks too have embraced HD technology and have steadily increased the amount of content being produced in this format. As of November 2006, 27 cable networks offer high definition programming on a full-time or part-time basis – in a variety of genres including news, sports, movies, and general interest. And as of June 2006, local cable systems also were carrying the digital signal of 788 unique broadcast stations, a seven-fold increase from January 2003, when 92 such stations were carried. And the agreement entered into between cable operators and public television stations in 2005 ensures that local public television digital programming is being carried on cable systems throughout the country.

The networks include A&E HD, Cinemax HD, Comcast SportsNet HD, Discovery HD Theater, ESPN HD, ESPN2 HD, Food Network HD, FSN HD, HBO HD, HDNet, HDNet Movies, HGTV HD, INHD, MHD (MTV HD), MSG Network HD, National Geographic Channel HD, NBA TV, NFL Network HD, Outdoor Channel 2 HD, Playboy HD, Showtime HD, Spice HD, Starz HD, TMC HD, TNT HD, Universal HD, and YES-HD.

Digital video recorders (DVRs) have become standard products offered by a range of video players: DVR product makers, cable, satellite and telephone companies. Every major cable operator offers DVR technology to its customers. Comcast, for example, has deployed 4.1 million advanced DVR set top boxes, many with HD capability. One out of three, or 34 percent, of Comcast digital customers have purchased this service, up from 21.8 percent of digital customers in September 2005. Cablevision has doubled the number of customers to its HDTV service since last year, increasing to 525,000 at the end of September 2006.⁶⁷ The technology is moving into uncharted territory with recently announced plans to offer an on-demand ad service to enable customers to research products or services similar to the way they search the Web for information.⁶⁸

The past year has also seen a growing demand for and proliferation of "video-on-demand" ("VOD") services – from entertainment fare to consumer products. According to Forrester Research, "an estimated 29 million households in the U.S. now have video-on-demand capabilities – more than double the number of households three years ago and almost reaching the same penetration as digital cable."⁶⁹

Cable is the leading provider of video-on-demand services, as free VOD has been one strategy employed by cable operators battling satellite and other competitors. For example, Comcast provides more than 7,500 video on demand programs each month available for viewing 24 hours a day in such categories as movies, TV shows, children's programming, sports and

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⁶⁷ "Cablevision HDTV Subs Double in 2006," www.tvpredictions.com/cablevisionhd110806.htm, November 8, 2006.

[&]quot;TiVo's Latest Viewing Option: Commercials," Wall Street Journal, May 8, 2006. ReplayTV, a DVR pioneer, has introduced a new service with software that turns PCs into DVRs. "DVR providers getting competition with a PC twist," USA Today, June 28, 2006.

⁶⁹ "Marketers Press the Play Button for Video on Demand Programs," Wall Street Journal, August 28, 2006.

fitness, music, lifestyle and home themes. Nearly 95% of these ON DEMAND programs are available at no additional charge. Comcast's 100-plus hours of HD ON DEMAND will double in 2007, and again in 2008.

Charter offers over 1200 hours of VOD, and added over 20 content providers in the last two years, as its service has seen significant growth. Similarly, Cox has added a wide range of content providers to expand its VOD offerings, along with increased local content. Smaller operators, such as Bresnan Communications, are rolling out expanded VOD products as well.

As VOD grows, cable operators are experimenting with advanced ad insertion technology in the video-on-demand space in an effort to compete with the much higher advertising yields in the Internet video space. And they are strengthening their competitive position by offering more local-oriented programming. Time Warner Cable, for example, is offering local programming in about two-thirds of its systems, along with interactive features. Time Warner's "Start Over" service, launched in November 2005, uses VOD technology to allow digital video customers to instantly restart from the beginning select programs as they are being aired. Time Warner also offers PhotoShowTVtm, which allows digital video and HSD subscribers to upload photo slideshows and videos for other system subscribers to view on their televisions via the VOD feature. Here are a few other examples of other advanced services offered by cable:

[&]quot;Comcast On Demand Tops Three Billion Views: Nation's Premier Video-On-Demand Service Features 7500 Programs," News Release, September 6, 2006.

⁷¹ "Cable Operators Test New Ad Models for VOD," ADWEEK, September 25, 2006.

[&]quot;MSOs Revamp VOD Strategies; Operators Roll Out More Local Fare, Interactive Services to Bolster Business," Multichannel News, May 1, 2006.

Charter

• Charter iTV – Provides interactive access to content including weather, entertainment (including movie descriptions and listings), games and puzzles, sports (including scores, stats and standings), news, and business news.

Cox

• **interACTIVE** – allows digital video subscribers to interact with select commercials and programs at the touch of a button on the remote control enabling viewers to do things like vote on community issues, request more information, or take advantage of special offers.

Insight

• **Localsource** – Interactive information and entertainment guide that delivers local news and weather, sports news, movie listings, dining guides, games and community directories and calendars.

Cable is also easing the transition to digital TV by working with the consumer electronics companies on universal standards for "Digital Cable Ready" equipment that allows subscribers to receive digital cable services without the need for a set-top box.⁷³

Packaged vs. A La Carte Programming

In today's video marketplace, where households can readily switch from cable to DBS (or, increasingly, to another cable provider), it's a competitive imperative that providers package

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The NOI (at ¶ 84) asks a number of questions with respect to CableCARDs – the separate security modules that cable operators provide to cable customers for use in accessing cable services in "Digital Cable Ready" devices. The questions asked in the NOI relating to number of cards placed in service, pricing, methods of installation and the like, are the same questions the Commission has asked cable operators to answer in quarterly reports to the Commission, the last of which was filed on September 29, 2006, which we incorporate by reference herein. See Letter from Neal M. Goldberg, NCTA, to Marlene H. Dortch, Secretary, FCC, CS Docket No. 97-80, September 29, 2006 (transmitting CableCARD reports from five largest MSOs). The next report will be filed December 22, 2006. Since the last report, CableLabs has announced further progress in developing multistream CableCARDs and testing procedures for compatible "Digital Cable Ready" devices so that consumers who use these devices may, for example, record one scrambled channel while viewing another. Specifically, Cable Labs has qualified M-Cards from Motorola and Cisco/Scientific-Atlanta and has reached an agreement with a number of consumer electronics companies (including representatives from TiVo, Motorola and Digeo Interactive) on new testing procedures to verify Digital Cable Ready devices that have an M-Card interface which permits the use of an M-Card in multi-stream mode. See Letter from Neal M. Goldberg, NCTA, to Catherine Bohigian, Chief, Office of Strategic Planning & Policy Analysis, FCC, CS Docket No. 97-80, November 14, 2006.

their services in the way that maximizes value for consumers. To achieve this objective, cable systems offer their customers a broad array of service options.

Beyond the basic tier that includes broadcast and access channels, which Congress requires all customers to buy, cable systems offer additional program networks and services in analog and digital tiers and mini-tiers. In addition, some services are offered on a "per-channel" basis, while others are offered on a per-program (pay-per-view) basis. Customers with high-definition television sets can purchase additional non-broadcast high-definition programming. They can purchase video-on-demand services. And they can lease a digital video recorder.

Sometimes, consumers – and policymakers – question why cable systems do not offer *every* program network and service on a per-channel "à la carte" basis. The FCC's Media Bureau conducted an extensive inquiry into this question and initially concluded – as had the Government Accountability Office – that a requirement that all channels be available to customers on an à la carte basis, even if they are also available in tiers, would make most consumers *worse* off. The Bureau found that consumers would have to pay more than they pay today to receive far fewer channels – fewer even than the number of channels that they regularly watch, much less the channels that they occasionally watch.

The Bureau also concluded that à la carte and themed tier requirements would significantly diminish the quantity, quality, and diversity of programming available to viewers. À la carte would cause many program networks to fail – especially networks aimed at minority and niche interests.

These findings were supported not only by economic studies and analyses supplied by affected parties and industries. They were also confirmed by a panel of four independent economists who were invited by the Bureau to testify at a symposium on the subject. The

economists explained why offering many basic cable services only on a tiered basis enabled more viewers to watch more program networks for a lower price than if the services could also be purchased à la carte.

Nevertheless, as the Notice of Inquiry in this proceeding points out, in February 2006, the Media Bureau released a *Further* Report "finding that greater choice *could* benefit consumers." NCTA submitted a comprehensive response to that Further Report, along with an economic analysis by Professor Steven Wildman of Michigan State University, which showed that the Bureau had failed to substantiate its revised conclusion, that the Bureau's critique of the First Report was itself plagued by methodological errors, and that the Bureau, in fact, had it right the first time. We incorporate by reference that response in these comments.

For purposes of this proceeding, the point is that competition is driving video competitors to offer customers a range of options in order to maximize value – and that the range of options that maximizes value includes the packaging of many services in tiers. DBS services generally offer their customers a similar array of tier, per-channel and pay-per-view options – except that they are not required to provide a basic broadcast tier to all their customers, and they are not yet technologically capable of providing on-demand services.

As technology changes and as the economics of the video marketplace evolve to take such change into account, the array of service offerings – and the way in which they are packaged – may change as well. But competition among providers will continue to ensure that consumers will have the options that provide the best value. So far, competition has already produced more

⁷⁴ Notice, ¶ 17 (emphasis added).

[&]quot;A Case of À la Carte and "Increased Choice"?" An Economic Assessment of the FCC's Further Report, Steven S. Wildman, Michigan State University, March 9, 2006.

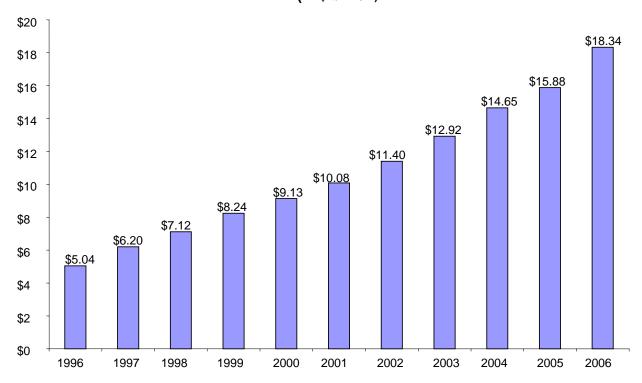
choices of what to watch *and* more choices of what to purchase than ever before. That trend is likely to continue.

Meanwhile, the programming marketplace remains as *competitive* as ever as investment in original programming continues to flourish, as delivery options explode, and as program packaging responds to marketplace incentives. The growth in cable digital capacity has spurred growth in national video programming services, up from 390 in 2004 to 531 in 2005. And program networks and cable operators have continued to expend more and more money to produce and deliver compelling, high quality programming for cable customers. In 2006, cable networks will invest more than \$18 billion in new programming, while cable operators will spend nearly \$21 billion on programming services.⁷⁶

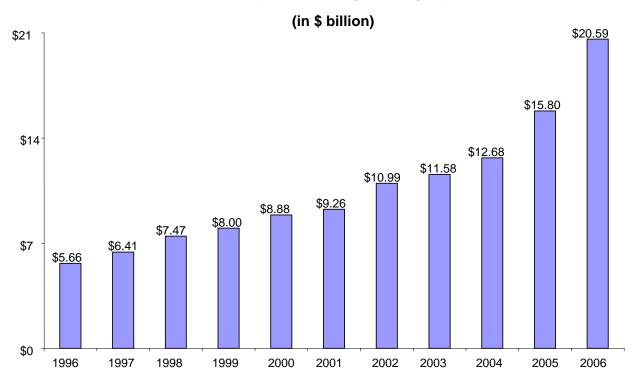
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Cable companies are also responding to "ballooning competition from startups, entertainment companies and large Internet sites" offering video on the Web by acquiring broadband rights and linking Internet content to TV sets. "Cable Takes on Web Video," Associated Press Financial Wire, June 29, 2006. Comcast, for example, is planning to make a wide variety of movies, TV shows and other video material available on its Web site. And it is introducing new technology that will enable its high speed Internet customers to route its Web-based video content to TV sets.

Cable Networks' Programming Expenditures (in \$ billion)



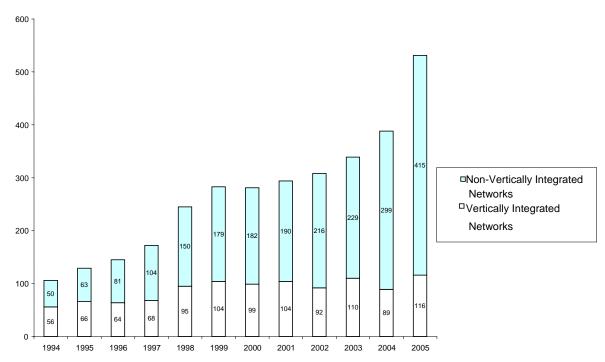
Cable Operators' Programming Expenditures



The small amount of vertical integration of cable operators and program networks is not a threat to marketplace competition. In 1992, 48% of all national cable programming services were owned by cable operators. By January 2002, that number had fallen to only 26%.

According to the Commission's 12th Annual Report, only 21.8% of cable programming networks were vertically integrated as of 2005.⁷⁷

Vertically Integrated and Non-Vertically Integrated Networks



But the notion that vertical integration alone automatically constitutes a threat to competition is not sustainable. And, in any event, with DBS a fully established competitor in the video marketplace, cable operators cannot refuse to carry a popular program network – whether vertically integrated or not – without risking losses in subscribership that outweigh any benefits.

operator.")

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Twelfth Annual Report ("In 2005, we identified 531 satellite-delivered national programming networks, an increase of 143 networks over the 2004 total of 388 networks. Of the 531, 116 networks (21.8 percent) were vertically integrated with at least one cable operator in 2005. Last year we identified 388 satellite-delivered national networks, 89 of which (22.9 percent) were vertically integrated with a cable

Moreover, DBS is now significantly vertically-integrated, and the level of programming exclusivity that DirecTV, the nation's second largest MVPD, holds now surpasses any held by cable operators, most of whom it dwarfs in size.

Meanwhile, as the percentage of vertically integrated networks continues to decline, the number of channels available on cable networks has expanded dramatically since 1992. Taken together, the decline in vertical integration, the increase in channel capacity, and the growth of retail competition from alternative providers have essentially mooted Congress's core concern that large cable operators could constrict the flow of diverse programming to consumers by favoring their vertically integrated networks.

Every indication is that the product offerings, levels of service, options, and bundling of services reflects a fully competitive marketplace; the choices are multiplying and the marketplace is working to provide the right mix of programming options for consumers.

Regulating here would be counterproductive to consumer interests. Consumers today have real choices in the video marketplace and they are exercising those choices as Congress intended.

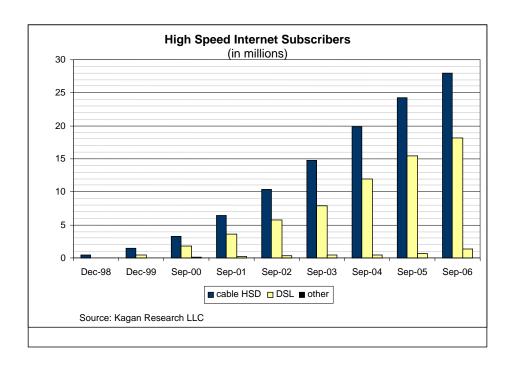
III. COMPETITION IS FLOURISHING IN THE PROVISION OF HIGH-SPEED INTERNET SERVICE

When cable operators decided to rebuild their facilities in order to provide a more robust multichannel video programming service they also set in motion a revolution in the provision of advanced broadband services. The digital plant that was built to transport bits of video information is also capable of transporting digitized data and voice information. And since the deployment of new facilities took place not long after the emergence of the Internet and the World Wide Web, cable operators were able to offer their customers a brand new residential service – high-speed Internet access.

High-speed Internet access was already available to *business* users via T1 lines offered by telephone companies. And it *could* have already been available from the telephone companies as a residential service over existing telephone lines. The technology for providing DSL service was already in place, but telephone companies underestimated demand for the service and chose not to deploy it lest it undercut their sales of the more lucrative (*i.e.*, expensive) T1 service, and ISDN plans.

Cable modem service not only responded to significant consumer demand for faster access to the World Wide Web. It also stimulated and created new and more intense demand by creating a platform for the delivery of new Internet services that were unimaginable in the era of dial-up service. High-speed cable Internet access has literally transformed the way we listen to, share and purchase music, the way we get our news and information, the way we shop, and the way we communicate. We send pictures and videos by e-mail, we communicate by "instant messaging," and we use webcams for online video chats. Cable modem service even provides the platform for Internet-based telephone services.

Once consumer demand for cable modem service became evident, the telephone companies entered the marketplace with their own DSL service. Having conceded a head start to cable operators, the telcos quickly captured a significant share of high-speed Internet customers. Today, 58.9% of all high-speed Internet households are cable modem customers, while 38.3% purchase DSL service.



Cable operators and telcos compete aggressively for new and existing Internet customers. Both providers already have facilities in place to offer high speed access to customers, and both vigorously seek additional customers to defray the sunk costs of their facilities investments. Moreover, because cable operators and telephone companies offer bundled service offerings that include telephone and video services in addition to high-speed Internet access, they have additional competitive incentives to ensure that their Internet offerings provide the best service and the best value to consumers.

While competition between DSL and cable modem service is already intense, several other technologies provide additional choices for consumers. These include satellite broadband, fixed wireless, mobile wireless, and WiFi networks. Satellite broadband service is available throughout the nation but its customer base today (1.3% of all high-speed Internet households) is largely located in those limited areas that cannot economically be served by cable modem or DSL service.

Fixed wireless broadband was once viewed with enormous potential, but technical shortcomings and the prominent business failures of Winstar and Teligent, among others, have stunted the growth of this alternative. Its subscribership has reached a plateau of approximately 1.5% of high-speed households.

Although WiFi networks are being explored or implemented in many areas, they still primarily serve public outdoor spaces and do not reach inside dwellings to provide household service. But Wi-MAX and broadband over powerlines (BPL) technologies, which are both in their infancy, have the potential to offer significant competition to cable HSD and DSL services. Just this month, the Commission took a step to facilitate the development of this new service by ruling that BPL, like DSL and cable modem service, should be classified as an "information service." The Commission noted that this step not only "establishes a minimal regulatory environment for BPL-enabled Internet access service that promotes our goal of ubiquitous availability of broadband to all Americans," but also furthers the Commission's goal of developing a consistent regulatory framework across broadband platforms by regulating like services in a similar manner."

High-speed Internet service is now ubiquitously *available* throughout the nation.

According to FCC data, cable modem service is available to 93% of the nation's households, and DSL is available to 78%. But only 46% of the nation's households choose to *purchase* high-speed Internet service.

⁷⁸ In the Matter of United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service, supra, ¶ 2.

⁷⁹ FCC, *High Speed Service fore Internet Access: Status as of December 31*, 2005; July 2006, at 3 and Table 14.

This shortfall in penetration increases the rewards and opportunities for providers who are able to offer greater value to consumers. By offering a better price-quality ratio, a provider can capture customers not only from its competitors but also from the large number of households that have not yet been persuaded to purchase the service. Given the large sunk costs of capital-intensive broadband facilities and the effect that a superior Internet service can have on the provider's video and telephone revenues, it's not surprising that cable operators and telephone companies are continually upgrading the speed and quality of their Internet offerings. And they are also continually searching for ways to offer service more efficiently at price points that maximize value to consumers.

In terms of quality, cable operators are upgrading the speed at which service is available. The standard speed on Cablevision Systems' Optimum Online service, for example, is now 15 Mbps, with 30 Mbps available for an additional \$9.95 per month. The standard speed for most cable HSD providers is now 6 Mbps, while the DSL offerings of the telephone companies carry standard speeds of 1.5 Mbps to 3 Mbps. These speeds have doubled or tripled within the last several years.⁸⁰

This is an enhancement that may not be noticeable to those who use the Internet mainly for sending e-mail and reading online newspapers and blogs, but that matters enormously for those who rely on the most bandwidth-intensive Internet sites and services, such as peer-to-peer file sharing, and the uploading and downloading of streaming video and music.

Insight recently announced ramping up its broadband speeds for business customers to 15 Mbps. Insight Press Release, "Insight Business Ramps Up Broadband Speeds," November 20, 2006.

These upgrades are costly, so operators are also seeking ways to enhance the speed and quality of service without excessively increasing the price of such upgrades – especially for those customers who are least likely to benefit from them. Technology is making it possible to offer "tiered" service to customers, providing the option to purchase higher speeds and greater bandwidth or to purchase a "basic" service at a lower price.⁸¹

In addition, if the marketplace supports it, broadband providers may be able to develop innovative business models that would shift some of the costs from consumers to large commercial web-based providers (who, in turn, could recover costs from the particular consumers who use them – and from other sources, such as advertisers). Such business models could be a win-win-win proposition for consumers, web-based providers, and broadband providers, as consumers would pay less and use more, commercial web-based providers could develop and market innovative new products and services, and broadband providers could sell more services since their retail pricing would be lower than it otherwise would be.

It is important that cable operators (and content providers) not be prevented, under the rubric of "net neutrality," from seeking innovative ways to maximize value to the maximum number of consumers. The Commission has, in this regard, consistently struck the right balance, adhering from the outset to its policy of "vigilant restraint." It has recognized the possibility that facilities-based providers of Internet access could conceivably act in ways that adversely affect marketplace competition. But it has refrained, in the absence of any indication that this is more than a hypothetical concern, from adopting prophylactic regulations that could do more harm than good.

Comcast recently rolled out its PowerBoost feature, a network technology that temporarily doubles Internet speeds at no additional cost for consumers subscribing to the company's 6 Mbps and 8 Mbps services, raising download speeds to 12 Mbps and 16 Mbps, respectively. Cablevision Buckeye offers a similar service.

Billions of Internet transmissions have occurred since the start of the network neutrality debate, and in only one instance has there been a complaint filed. Responding to a complaint filed by Vonage, the FCC moved swiftly in reaching a deal with Madison River Communications in which the company agreed to "refrain from blocking" VoIP traffic.⁸² This ratio speaks volumes about the absence of a market failure justifying regulation.

Fierce competition between cable operators, telephone companies and other providers of Internet access will drive them to continue to seek ways to attract and retain not only the heavy users of Internet service but also those households that have not chosen to purchase the service. The Commission should continue to promote this pro-competitive result with its policy of vigilant restraint.

IV. CABLE IS BRINGING COMPETITION TO THE TELEPHONE MARKETPLACE

Ten years ago, when Congress enacted the Telecommunications Act of 1996, cable operators and telephone companies promised to bring new competition to each other's core businesses. Telcos, which previously had been barred from providing cable service in their telephone service areas, promised to do so if the prohibition was repealed. Cable operators, which had been subject to stringent rate regulation, promised to rebuild their systems and bring new competition to the telephone marketplace if Congress eliminated regulation of rates for the expanded basic ("cable programming service") tier.

One of these parties immediately set about to keep its promise. The cable industry, since 1996, invested more than \$100 billion to upgrade facilities in order to compete in the new digital broadband marketplace. Meanwhile, cable operators began exploring ways to use their facilities to provide local telephone service – just as they said they would. Even before the development

http://news.com.com/Telco+agrees+to+stop+blocking+VoIP+calls/2100-7352_3-5598633.html.

and deployment of Voice-over-Internet-Protocol ("VoIP") telephone service, some operators offered robust circuit-switched telephone service that was fully competitive with the incumbent local exchange carriers.

With the development and deployment of VoIP technology, the cable industry is offering consumers across the nation a competitive choice of facilities-based local wireline telephone providers. Cable telephone service is now available to more than 73% of the nation's households, and it is already being purchased by 8.5 million customers. And it is now clear that not only cable's circuit-switched offerings but also its VoIP service is being marketed and purchased as a *substitute* for the primary local telephone service of the ILECs. 83

It's still the case, of course, that the ILECs have the lion's share of residential households. Unlike the other two components of the bundled "triple play" offerings of broadband providers, the telephone marketplace is still characterized by the dominance of one major provider. This imbalance is not simply because of consumers' reluctance to switch to new providers, or a superior incumbent's offering. Where cable operators and Internet-based VoIP providers have begun offering competitively priced phone service, consumers have shown that they are more than willing to switch.

But the ILECs have a unique ability to slow down and raise the costs of their local exchange competitors. And they have a history of using the anticompetitive tools at their disposal. Unlike the video marketplace, new competitors in the telephone marketplace cannot succeed merely by offering a superior product or by offering better prices. Because of the

See e.g., J.D. Power and Associates Press Release, "Cable Companies Dominate Customer Satisfaction Rankings for Local and Long Distance Telephone Service," July 12, 2006.

http://www.jdpower.com/corporate/news/releases/pressrelease.asp?ID=2006108. (While telephone service offered by cable companies is relatively new to the market, large numbers of customers are being lured to switch with enticing cost savings and highly attractive bundles of video, voice and data service.")

unique "network effects" associated with the offering of telephone service, a newcomer cannot enter the marketplace without the active cooperation and assistance of the incumbent provider.

Who, for example, would switch to a new provider if, after switching, they could not call or receive calls from the incumbent's customers? But, as Congress and the Commission have recognized, a new provider's customers will not be able to reach the incumbent's customers unless the incumbent cooperates by providing, for example, interconnection and other necessary services and facilities. And because the ILECs have obvious incentives *not* to cooperate – and a history of anticompetitive conduct to preserve their local exchange monopoly – Congress and the FCC have imposed rules *requiring* interconnection and other necessary cooperation.

One reason why the telcos are only now beginning to implement their 1996 promise to provide *video* competition is that they spent most of the last ten years resisting and challenging those rules and requirements in order to thwart competition in their core telephone business. A multitude of competitive local exchange carriers (CLECs) blossomed in the aftermath of the 1996 Act. As documented in previous video competition reports, some began offering the "triple play" of bundled video, voice and Internet service, even before many cable operators and ILECs were doing so. It's unlikely that all of them would have survived in a competitive marketplace. But it's not at all unlikely that those that were most efficient and effective at providing value to consumers would have become long-term competitors.

But the telcos' 10-year battle against effective implementation of the 1996 Act has precluded this outcome. Today, the CLECs, after engaging in endless proceedings and struggles

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One Bell Company – Ameritech – did, in fact, begin deploying cable television facilities shortly after enactment of the 1996 Act. Indeed, Ameritech had no difficulty obtaining more than 100 cable franchises and was well on its way to providing competitive cable service. But when SBC acquired Ameritech in 1999, it pulled the plug on Ameritech's cable plans, and, like its ILEC brethren, turned its attention to preserving its local telephone monopoly.

to gain interconnection, access to unbundled elements, prompt porting of telephone numbers, and other essential cooperation from the ILECs, have all but vanished. Their primary competitors, AT&T and MCI, were acquired by the incumbent themselves. And now, the ILECs appear to be turning their attention to their cable competitors, who offer the best remaining prospect for long-term competition in residential phone service.

Consumers will be the beneficiaries of a vigorously competitive marketplace in which providers expand beyond their core businesses to offer telephone, voice, video and Internet – and, in some cases, *wireless* telephone – services. While wireless service is already an important supplement to many consumers' communications services, it is increasingly, for younger generations, treated as a substitute for wireline phone service. In addition to their current dominance in the provision of local telephone service, the ILECs already have a head start in transforming their bundled "triple play" offerings into a "quadruple play." Through mergers and acquisitions, they already own two of the largest providers of wireless phone service – Cingular and Verizon Wireless. And they have acquired additional spectrum for wireless use in the Commission's recent auction.

But the benefits of competition in *all* of these services depend on preserving fair competition in *each* of them. If consumers are expected increasingly to purchase all these services from a single provider, then the effects of anticompetitive conduct in the provision of one of these services have a spillover effect on the provision of the other services.

More specifically, if the LECs were able to thwart or unfairly raise the costs of competition from cable companies in the provision of local telephone service by, for example, impeding interconnection or by failing to facilitate number portability in a timely manner, the effect would not only be to impair competition in the telephone marketplace. They have already

started down this path, resisting requests by cable operators to allow operators to choose technically feasible points of interconnection, including a single point of interconnection in a LATA.⁸⁵ And while LECs have virtually no competition in the provision of essential transiting services, they have refused to recognize any obligation to include transiting services in their interconnection agreements with cable operators.⁸⁶

By making it harder or costlier for cable operators to offer competitive local telephone service, the ILECs would make the cable operators' bundled "triple play" offerings less attractive and more expensive for consumers – which would, in turn, make their own packages relatively *more* attractive. As a result, the ILECs could not only retain their dominance in the telephone marketplace but could also unfairly leverage that dominance into the video and high-speed data marketplace, capturing cable and Internet customers for reasons that have nothing to do with superior efficiency or a superior product.

For this reason, the belated entry of the Bell Companies into the already competitive video marketplace offers the prospect of still more choice for consumers – but it also raises a threat to the vibrant competition that currently exists. To preserve the best prospect of local telephone competition *and* to preserve fair and vigorous competition in the provision of video, Internet, and wireless services, the ILECs' propensity to delay and deny necessary cooperation with competitors in the provision of telephone services must be held in check. Vigilance in ensuring such cooperation and in preventing anticompetitive conduct will reap enormous rewards for consumers. It will ensure that the competition that has characterized the video

See, e.g., Comments of Advance/Newhouse Communications, et al. on AT&T's Proposed Conditions on AT&T, Inc. and BellSouth Corporation Applications for Approval of Transfer of Control, WC Docket No. 06-74, Oct. 24, 2006, at 5-8.

⁸⁶ *Id.* at 16-19.

marketplace in the Commission's annual reports will continue to flourish and will extend into the Internet and telephone marketplace.

CONCLUSION

It's hardly news anymore that the video marketplace is vibrantly competitive. Head-to-head competition between cable operators and two national DBS providers – and, now, the large incumbent telephone companies – continues to drive innovation and maximize value for consumers. The interesting news is that competition in the video marketplace – and the rebuilding of cable facilities to meet that competition – has had a competitive spillover effect in the provision of *non-video* services.

Competition is now flourishing in the provision of high-speed Internet services. And cable operators are vigorously competing to provide local telephone service across the country. Unlike the video and high-speed data markets, the local telephone marketplace is still dominated by the ILECs. But at long last, there is a real prospect of fully effective competition in that marketplace, so long as the Commission is vigilant in preventing the ILECs from foreclosing such a development.

Competition in the video marketplace and in the high-speed Internet marketplace is here to stay, and, with a watchful eye, the Commission can ensure that competition becomes the hallmark of the telephone marketplace as well.

Respectfully submitted,

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November 29, 2006

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